South Vietnam—What Future for the Economy?

TO the millions of servicemen who have been there—and to hundreds of millions of TV viewers all over the world whose nightly news has carried a seemingly endless succession of jungle patrols and trucks mired in mud—the economic future of South Vietnam must seem almost hopeless. But the fact of the matter is that by the standards of many developing nations South Vietnam is by no means an unblessed country. Not only does it have considerable potential for agricultural production and development of its abundant timber and seafood resources; as a legacy of the war, its infrastructure of communications and transportation facilities is much more extensive than that typically found in less developed nations.

Such assets—coupled with the substantial training many Vietnamese have received in various fields during the war years—could provide the basis for fairly rapid economic progress, if the cease-fire accord results in reasonable political and military stability. This is particularly so because economic planning for the postwar period is already well advanced, an unusual circumstance before the end of a major war.

The key assumption, of course, is that of reasonable political and military stability. At present, according to the U.S. Defense Department, the government controls areas inhabited by about four fifths of the population—including most of the critically important Mekong Delta "rice bowl" and a major part of the country's extensive coastal plains which also are rice-producing lands. But control of large parts of the nation—particularly its less populated regions—is still contested. And the possibility of a new breakout of full-scale warfare cannot be ruled out, particularly in view of reports that North Vietnam has been engaging in a major build-up of troops and weapons in South Vietnam. Washington has conveyed its concern about the infiltration to North Vietnam and "other interested parties," President Nixon noted recently, pointedly warning Hanoi against lightly disregarding the U.S. concern.

The way in which things evolve obviously will depend heavily on whether the general thaw that has been in progress in relations between the United States and the Soviet Union and China continues. Relative tranquility in South Vietnam also clearly will be affected by the degree of interest the North Vietnamese have in receiving U.S. reconstruction aid. In both instances, the imponderables are formidable.

High on the list of South Vietnam's priorities is the regaining of self-sufficiency in rice production, which was lost during the worst years of the war as many farmers left their paddies. Rice, a dietary staple, traditionally has been the country's largest crop and the second largest export after rubber. Another high priority is to increase exports so as to start closing a huge trade gap.

To close that gap, which last year totaled the equivalent of about $650 million, government officials are convinced that reliance on the old standbys of rice and rubber won't be enough. Rice production has been expanding rather impressively in recent years, after having fallen sharply in the mid-1960s, but for the next few years a realistic goal seems to be domestic self-sufficiency rather than a return to substantial exportable surpluses. Partly this is because internal demand has grown rapidly, reflecting both the swift income rise produced by the war and a very high rate of population growth. In the case of rubber, whose production fell by two thirds from the early to the late 1960s, the

chances of getting back quickly to the position of sizable export earnings ($48 million in 1960, for example, against less than $10 million annually recently) are almost nonexistent, in part because of the long tree-growth cycle.

Because both rice and rubber have somewhat clouded export potential, officials are counting heavily on development of new export products, and economic plans call for agricultural diversification into such lines as livestock, fruits, and vegetables—something for which the country is well suited as it can grow tropical, subtropical, and temperate crops. Officials also have high hopes pinned on greatly enlarged timber and fish production. About three quarters of the country is forested, and its coastal waters abound in shrimp and other seafood. Another early endeavor on the drawing boards is exploration for petroleum, which geologists suspect may be present in sizable quantities under the continental shelf.

A ballooning budget

A legacy of virtually all wars is budgetary strain, and Vietnam—not surprisingly—fits the pattern. Saigon's planners are mindful that some of the country's main economic difficulties stem from a ballooning of the national budget during the past several years. And they appear to appreciate that getting the fiscal situation under tighter control looms as an urgent need. Expenditures multiplied nearly seven times between 1965 and 1972 from 54 billion piasters to P355 billion, as the government took on more of the responsibility for the war. Military manpower, for instance, nearly doubled during the period, from 600,000 men to 1.1 million—a formidable drain on resources for a nation of some 19 million people whose labor force is estimated at between 6 million and 7 million.

Although the Vietnamese experienced unprecedented income gains during the war years, the government did not tax the population nearly enough to pay for the spiraling expenditures. The combination of import duties, which are particularly important in Vietnam's tax structure, and domestic taxes has on average financed less than three fifths of the budget in recent years. Given the circumstances that prevailed—and the heavy emphasis which the government placed on not alienating the populace—this is perhaps understandable. But the revenue deficiency did create serious financial difficulties, despite supplemental budget support from the U.S. The government ran growing deficits whose financing helped fan an inflation, averaging 30% a year, that gripped the country from the mid-1960s on.

Partly with the aim of containing price increases, the U.S. encouraged a huge volume of imports. The recorded value averaged more than $700 million annually between 1966 and 1971 —during most of which time exports averaged a mere $12 million annually. Surely this must be a world record of sorts in trade imbalance.

Imports included food and other necessities, as well as a significant supply of consumer goods such as motor scooters—earning South Vietnam the nickname "Honda Society." The imbalance between imports and exports was possible in part because more than half the bill was financed by direct U.S. aid. This came principally through the so-called Commercial Import Program (CIP), under which goods, with a few exceptions, have to be bought in the U.S., and through agricultural sales under the Food for Peace—PL480—program. A good part of the balance was financed by the South Vietnamese government with "free" foreign exchange usable anywhere. This was derived essentially from the U.S. military's purchases of piasters to pay for local goods and services.

However well-intentioned, the import program had some unfortunate consequences. For one thing, the revenue it generated permitted the government to put off the day of domestic tax reform. And it accustomed the population to standards of consumption unrealistically high in terms of what the country itself could provide. The program also was accompanied by a good deal of abuse, in part reflecting deficiencies in the foreign-trade mechanism.

Among the deficiencies was the piaster's exchange rate, which was fixed at a level that represented a significant overvaluation. And tariff schedules on imports were so complex and so high—in some cases imposing duties as much as tenfold the value of the imported product—as to defy administration. These things, together with a variety of controls on transactions, led to smuggling and other illegal activities that resulted in loss of government import taxes and a slippage of foreign exchange into unofficial channels.

Response to the problems

The framework of a multi-thrust response to Vietnam's various problems has begun to take shape. Indeed, in some areas the attack already is producing significant results. Most spectacular of all is the degree of success achieved in reversing the decline in rice production, which fell from a 1963 high of 5.3 million metric tons to an average of 4.5 million tons in the 1966-68 period. The most troublesome feature of that fall-off was the abrupt disappearance of Vietnam's exportable surplus. It had amounted to 300,000 tons in 1963, but in 1967 the country imported 750,000 tons.

An impressive turnabout in the rice situation has since occurred. By 1971 output was estimated at 6 million tons, well above the 1963 high. Last year's major offensive by North Vietnam, even though concentrated in non-rice producing areas, caused some setback. But prospects for a resumption of growth in the rice crop are good—with the critical proviso that the cease-fire accord works.

The turnabout reflected a number of developments, including the introduction of high-yielding "miracle" rice strains in 1967, a major expansion of agricultural credit facilities, and a bold policy of land reform aimed at strengthening the rural population's resistance to the Vietcong by ending the widespread pattern of tenant farming. The policy of land reform deserves emphasis—especially since relatively little attention has been given to it in general commentary on Vietnam. In March 1970 the government adopted a "Land-to-the-Tiller" act, which provided for expropriation—with compensation—of lands not directly cultivated by owners and for distribution of the lands, free of charge, to farmers. The law covered about 1 million hectares (approximately 2.5 million acres), representing some two fifths of the riceland under cultivation, and affected some 700,000 tenants. Transfers of title began in 1970 and, as planned, they will be just about completed on the act's third anniversary this month. Thus freed from rent payments, farmers have had a marked incentive to increase output.

Agricultural production, moreover, has been stimulated by steps to expand agricultural credit significantly, both through the official Agricultural Development Bank (ADB) and through a new system of quasi-private rural banks which accept deposits and make loans in local communities. Established in 1970 and jointly capitalized by ADB and private stockholders, the rural banks multiplied rapidly to some 34 in 1972 and quickly began to attract local funds.

Incentives to save—in rural banks and other financial institutions—were provided by a

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sharp increase in interest rates in the autumn of 1970. Before that step, people had little reason to put money into banks because institutions were limited by regulation to paying deposit interest rates that were well below the rate of inflation. But with the 1970 reform, private saving in all commercial institutions almost quintupled from the end of 1970 to the end of 1972.

A start with tax reform—another vital requisite to economic revitalization—has been made. During the past few years the government has taken several actions to revise its complicated—and frequently unenforceable—tax code and to step up collection efforts. The aim was to raise the small 20% share that internal taxes (as distinct from import taxes) had been playing in financing the national budget to 50% by 1975, and this has shown promising results. In 1972, internal tax collections increased some two fifths over the 1971 total, rising to an estimated P70 billion from P49 billion.

Further, in November 1971 the government made a sweeping overhaul of the foreign-trade system. Besides a major devaluation of the piaster, this included adoption of a mechanism permitting periodic rate adjustments. With this reform, the piaster has been devalued progressively from P275 per $1 in 1971 to P475 per $1 currently (except for imports under the U.S. CIP and PL480 programs, which are given special treatment). As companion measures, the government scrapped various of its former controls—such as the licensing of importers to buy foreign exchange—and simplified the tariff structure, reducing levies significantly on many items.

The package entailed some initial cost in that the government's import-tax collections are estimated to have dropped in 1972 to less than half their 1971 level. But the simpler tariff schedule and lower duty rates are expected to make it possible to improve customs collections in the long run. Meanwh[illegible] exports have responded to the devaluation an[illegible] certain subsidies that were later adopted.

In combination [illegible] the budget, currency, and trade stabilization [illegible] measures have had a significant impact on pr[illegible] increases, reducing inflation from the av[illegible] annual rate of 30% during the late 1960s to ab[illegible] 14% in 1971. While the rate rose again in [illegible]72 to some 23%, in part reflecting the de[illegible]ation's impact in raising import prices, infl[illegible] is expected to be held to 10%-15% this y[illegible]

All in all, the [illegible]s thus have done much to make a start [illegible]recting basic problems and laying a fou[illegible] economic development—no small [illegible] especially under wartime conditi[illegible] Vietnam's ability to follow throu[illegible]ined to a critical extent by whethe[illegible]eral years bring a sizable flow of [illegible] and investment. Without such inf[illegible]untry obviously will face serious [illegible] maintaining and improving living s[illegible]

Budgetary unc[illegible]ties

Of course, som[illegible] the difficulties would be alleviated if the n[illegible] few years permit any significant demobiliz[illegible]on of the armed forces. This would not o[illegible] ease strains on the budget, some three fifth[illegible] which has been devoted to military expendi[illegible] but it would help economic performan[illegible] as well. Military needs have created a shortage of manpower, particularly in agriculture where the labor market has been tightest. A more adequate labor force in agriculture will be critical for development and export growth, sin[illegible] exports are expected to come mainly from [illegible]s sector. But the outlook for demobilization obviously is highly uncertain at this time.

Even if the military situation turns more promising than it now looks, however, other expenditure requirements will be a heavy drain on the budget. Among them are the expenses of supporting and eventually resettling refugees estimated to number a million and a quarter, and benefit payments to disabled veterans and families of war victims.

The U.S. has provided economic support averaging approximately $500 million a year since 1968.* But with Congress having cooled considerably in recent years toward foreign aid generally, there plainly is no assurance that U.S. aid will be continued at the past level. And while other countries—including Japan, Germany, and France—have indicated an intention to provide postwar assistance, no commitments have as yet been made as to amounts or types of aid. If U.S. support is cut back significantly—in the absence of offsetting aid from other sources—Vietnam would face the need for severe belt-tightening, possibly involving expenditure cuts and the need to do more than has been done thus far to increase domestic revenues. Farmers in particular have been lightly taxed, and the government might have to turn to agriculture for more revenues. But with the government needing the rural population's support and anxious to encourage a reflow of persons to farms, this might prove difficult politically and questionable in terms of rational population distribution.

Needed: foreign exchange

The government also would be on politically sensitive ground if it found itself obliged to curtail imports because of a shortage of foreign exchange. But imports will have to be curbed unless a replacement is found for the "free" foreign exchange that has been derived from the U.S. military's purchases of piasters. With the pullout of U.S. troops, dollars from this source have been drying up fast. They were almost halved between 1971 and 1972—dropping from $403 million to $229 million—and will fall sharply again this year.

That South Vietnam has not as yet experienced a severe shortage of "free" foreign exchange reflects some fortuitous circumstances. The most important is that an economic setback last year produced a decline in import demand. The U.S. Agency for International Development (AID), moreover, has cushioned the exchange losses from military withdrawal through a new program of refugee aid. With the 1972 invasion, refugee rolls swelled by about a million, and AID purchased piasters to help the government defray the expenses of support. But this was a stop-gap measure. The country's economic progress in the next few years clearly depends on more permanent aid arrangements to help tide it over until expanded exports can become a more important earner of foreign exchange.

An export drive already is under way, stimulated by hefty subsidies which enable exporters to earn 100 to 125 piasters per dollar more than the going exchange rate of P475 per $1. This encouragement unquestionably was a factor in the rise of export earnings to $23 million in 1972, double the 1971 level. But the country's prospects of achieving the many-fold increases that will be needed to bridge the trade gap are still highly questionable.

Improved security and additions to the labor force will be critical to the effort, as will stepped up investment. Fishing, for instance, is still mainly a small-scale enterprise; sizable export growth in this promising area seems likely to require development of large-size commercial

* This includes financing of the Commercial Import Program, which has yielded budget revenues; aid for special projects; and PL480 sales, from which most of the piaster proceeds have been used to support the budget.

operations. Realizing the nation's wood and wood-product potential also will necessitate big investment outlays.

Significantly, from the legal point of view, the investment climate was vastly improved with the government's adoption, last June, of a law that provides liberal incentives for both domestic and foreign investment in approved enterprises. But while a number of foreign firms have been exploring opportunities of late, any big inflow of investment capital doubtless will await clarification of political and military conditions. This is particularly so of U.S. firms since at present the facilities of the U.S. government's Overseas Private Investment Corporation (OPIC) —which insures investors in developing countries against certain risks—are not available for investment in South Vietnam. However, if reasonable security is attained, it is possible that the U.S. will extend OPIC facilities for investment in that country.

If the investment climate does in fact become attractive, in time Vietnam may be able to develop industries outside the fields of agriculture, fishing, and timber with large potential for earning foreign exchange. Geological configurations have suggested to experts that the country may find sizable petroleum reserves offshore, perhaps enabling it to become a significant producer—as neighboring Indonesia has become in recent years. Looking even farther ahead, Vietnam conceivably could develop a thriving tourist industry, drawing visitors from more populous and prosperous neighbors to its attractive beaches, which extend from a point below Saigon several hundred miles up the coast.

The key to South Vietnam's progress clearly lies in a resolution of the political and military unknowns which now cloud the country's future. Obviously, the situation is still open-ended. However—to a greater extent than is commonly appreciated—a constructive start has been made in creating a framework for economic development. South Vietnam may yet surprise the doubters.